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IN THE

Supreme Court of the United States

October Term 1978

No. 78-999

STEERE TANK LINES, INC.

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

RONALD M. MANKOFF
CHARLES D. PULMAN

3900 First National Bank Bldg.
Dallas, Texas 75202
(214) 748-0074

Attorneys for Petitioner

Bowne of Dallas Printed in U.S.A.

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Petitioner,

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PETITION FOR A WRIT OF CERTIORARI
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FOR THE FIFTH CIRCUIT

Petitioner, Steere Tank Lines, Inc., prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit dated July 28, 1978, affirming the judgment of the United States District Court for the Northern District of Texas.

OPINIONS BELOW

The opinion of the United States District Court for the Northern District of Texas is reported at 38 A.F.T.R.2d

5484. The opinion of the Court of Appeals for the Fifth Circuit is reported at 577 F.2d 279. Both opinions are included in the Appendix.

JURISDICTION

The judgment of the Court of Appeals was entered by the Clerk on July 28, 1978. Petitioner's Motion for Rehearing was denied on September 25, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether Petitioner's payments to Tri-State Insurance Company are deductible under §162 of the Internal Revenue Code of 1954 (the "Code") as premiums paid pursuant to a true insurance arrangement with a legitimate, unrelated insurance company;

2. Whether Petitioner's payments to Tri-State Insurance Company are deductible as ordinary and necessary business expenses because the "all events" test of §461(a) of the Code has been satisfied.

STATEMENT OF THE CASE

This income tax case involves the ultimate question of the timing of deductions for the business cost of a trucking company's injuries to others. The immediate issue is whether Petitioner entered into an insurance arrangement under which Petitioner's payments, designated as "premiums", were entitled to an income tax deduction under §162 of the Code when paid, or whether Petitioner must wait until losses are actually paid by its insurer before those costs can be deducted under §162.

The sum of $222,092.07 paid as premiums in 1972 was disallowed as a deduction to Petitioner by the Commissioner of Internal Revenue. Petitioner paid the deficiency in income tax, $50,197.32, and sued for refund in the United States District Court for the Northern District of Texas ("District Court") under the authority of 28 U.S.C. §1346(a)(1). The District Court's findings of fact and conclusions of law were filed on June 15, 1976; judgment was entered on July 6, 1976. Petitioner timely filed a Notice of Appeal to the United States Court of Appeals for the Fifth Circuit ("Fifth Circuit") on September 2, 1976, under 28 U.S.C. §1291. On July 28, 1978, the Fifth Circuit entered its judgment. Petitioner filed a timely Petition for Rehearing, which was denied on September 25, 1978. The decision of the Fifth Circuit is reported at 577 F.2d 279.

During the year in question, Petitioner was a Texas corporation transporting petroleum products in intra and interstate commerce. In the operation of its business, Petitioner used its own trucks and also leased trucks that were owned and operated by independent contractors ("owner-lessors").

Because of the nature of its business, Petitioner was required by federal and state regulatory agencies to maintain insurance coverage against accident claims. Petitioner's poor accident history foreclosed the normal insurance routes. To meet its insurance requirement, Petitioner entered into a contract with Tri-State Insurance Company ("Tri-State"), an unrelated, qualified Oklahoma insurance company. According to the terms of the contract, Tri-State agreed to provide the federal and state regulatory agencies with the required evidence of financial responsibility and to insure Petitioner and the owner-lessors against liability up to $50,000 per accident. For this agreement, Tri-State was to receive premiums based upon a percentage of Petitioner's and owner-lessors' gross revenues (which, in turn, was based upon mileage) with a

$6,000 minimum annual premium. In addition, Petitioner and the owner-lessors agreed to maintain a deposit of $60,000 (known as "premium advance") with Tri-State. No deduction was claimed for the premium advance. In addition, Tri-State was to receive a premium (based upon the receipts of Petitioner and the owner-lessors) to be deposited by Tri-State into a reserve for losses known as the "premium contract account". The amount of this last premium, $222,092.07 in 1972, gives rise to the present controversy.

The premium contract account was to be Tri-State's insurance risk reserve for payment of claims against Petitioner and owner-lessors. After six years had elapsed from the date of any accident (the maximum statute of limitations), Petitioner was entitled to a refund or premium credit equal to any amounts in the premium contract account no longer necessary as a reserve against that accident.

Claims against Petitioner and owner-lessors were paid by Tri-State from the premium contract account regardless of whether the accident involved a vehicle owned by Petitioner or an owner-lessor. In the event a claim exceeded the amount in the premium contract account or other insurance carried by Petitioner, Tri-State would be obligated to pay the excess claim, but Petitioner agreed to indemnify Tri-State for that excess.

Tri State entered into an agreement with Adjustment and Inspection Company ("A & I") whereby A & I agreed to establish a safety and inspection program for Petitioner and to act as Tri-State's adjustor on claims brought against Petitioner. More relevant to the court below, A & I was contractually delegated the responsibility of managing and investing the funds in the premium contract account, subject to legal limits on the investment of Tri-State's insurance reserves. A & I's compensation for its services was

measured by and paid from the income of the premium contract account. A & I's stock was owned by independent trusts for the benefit of the children of the stockholders of Petitioner, who were officers of A & I.

The District Court denied part of Petitioner's 1972 premium deduction on the ground that "Tri-State was not Steere's insurer because Tri-State has no risk beyond Steere's insolvency." 577 F.2d at 283. The District Court concluded that the arrangement "lacked the fundamental aspects of an insurance agreement since the agreement did not shift the risk of loss to Tri-State, and there was no genuine pooling of risk." 577 F.2d at 283.

While recognizing that Petitioner lost control and benefit of the funds paid to Tri-State and deposited in the premium contract account, the District Court nevertheless concluded that this factor was not sufficient to establish deductibility because "the mere loss of control is not sufficient to establish deductibility" under these circumstances. In substance, the District Court concluded that Petitioner was a self-insurer. Thus, most of the premiums paid to Tri-State represented "[r]eserves or deposits established by a taxpayer against contingent or future liabilities. . . ." 577 F.2d at 282.

REASONS FOR GRANTING THE WRIT

The Fifth Circuit's decision in this case should be reviewed because of its conflict with the decision of the Circuit Court of Appeals for the Eighth Circuit ("Eighth Circuit") in *U.S. v. Weber Paper Co.*, 320 F.2d 199 (8th Cir. 1963). That case held that payments designated as insurance premiums under similar insurance arrangements were deductible under §162 as ordinary and necessary business expenses. The instant case presents an important and unsettled question to the trucking industry, to the Government and to the insurance industry: The elements

that are necessary to constitute insurance for purposes of deductibility under §162 of the Code and the related questions of defining "risk shifting" and "risk distribution". The prior decision of the Eighth Circuit was erroneously distinguished by the Fifth Circuit by reference to facts and conclusions that are not distinguishable. This Court's guidance is needed in resolving this conflict between two Circuits and the issues presented by the instant case.

1. THE FIFTH CIRCUIT'S CONCLUSION THAT PETITIONER'S ARRANGEMENT WITH TRI-STATE DID NOT CONSTITUTE TRUE INSURANCE IS IN CONFLICT WITH *United States v. Weber Paper Co.*

It was the Government's position in the instant case that *Weber* should not be applied because it was wrongly decided. The Fifth Circuit however chose to avoid the direct confrontation so requested and found instead that *Weber* was distinguishable by its facts.*

Petitioner respectfully submits that either *Weber* is wrong or *Steere* is wrong. Both cases cannot correctly state the law as to what constitutes true reciprocal insurance or retrospective premiums.

a. The Facts In *Weber* Are Not Distinguishable From The Case At Bar. As in the case at bar, Respondent denied Weber Paper Co. the right to deduct premium payments. The Fifth Circuit gave this description of the facts in *Weber*:

> In that case, several businesses which were unable to get flood insurance set up a reciprocal, inter-insurance plan, under which they paid yearly premiums to a corporation they set up for that purpose, Payments for losses were made, pro rata, from the fund composed of all subscribers' premiums. If a subscriber withdrew from the plan, up to 99% of its premium payments could be returned if no losses had been paid out of the common fund. The Eighth Circuit held the premiums paid under this plan to be deductible business expenses.

577 F.2d at 280.

* The District Court had not cited any cases in its opinion, and, therefore, did not either distinguish or reject *Weber*.

Under the terms of the *Weber* insurance agreement each subscriber was insured against loss equal to the amount of its annual premium. Thus, a subscriber paying an annual premium of $10,000 was insured against loss in the amount of $10,000. The subscribers' premiums were credited on the books of the insurance company to a Catastrophe Loss Account. Like A & I, the attorney-in-fact for the insurance company in *Weber* managed the reserves and charged the Catastrophe Loss Account with 1% of the insurance coverage, which amount, designated as the General Reserve Fund, would be used to pay losses if the Catastrophe Loss Account became exhausted. If all funds were exhausted, the attorney-in-fact, with the consent of an advisory committee elected by the subscribers, could require each subscriber to pay an amount equal to one year's premium to be used to cover excess losses. Since the insurance company had no other policyholders, any losses not met by the reserve fund would be paid by the individual subscribers. The Government in *Weber* argued that the risk of loss was not shifted to the insurance company but was borne by each subscriber. The Government also argued that any flood would damage all of the subscribers proportionately. *Weber Paper Co. v. United States,* 204 F.S. 394, 399 (W.D.Mo. 1962), *aff'd* 320 F.2d 199 (8th Cir 1963). The earnings of the insurance reserve funds were credited to the account of each subscriber. At the end of any fiscal year, a subscriber could, on 60 days' notice,

withdrew the entire remaining portion of his share in the Catastrophe Loss Account, as well as his accrued income from this account.

As in the instant case, the Government argued in *Weber* that premium payments are not deductible if the arrangement does no more than establish a reserve for future losses. The Eighth Circuit, however, held that the payments in *Weber* were insurance premiums deductible under §162 as an ordinary and necessary business expense. The Eighth Circuit held that true insurance premiums are paid and not a mere "contingency reserve" established when the insured loses control to a legitimate insurance company of the payments that the insured "was required to make to obtain the protection desired and applied for." 320 F.2d at 204.

b. Petitioner's Arrangement With Tri-State More Clearly Constitutes Insurance Than The Arrangement In *Weber*. A comparison of the insurance arrangements in each case shows that the form and the substance of Petitioner's insurance arrangement is more supportable as insurance than the arrangement in *Weber*. In both cases, the insured entered into an agreement with a legitimately chartered insurance company for protection against flood losses or liability losses. In *Weber*, the company was created and controlled by the insured. In the case at bar, Tri-State was independent. In both cases, the arrangement was the only means available for obtaining necessary insurance protection. In both cases, the insured had the right, subject to proper restrictions, to withdraw funds held by the insurance company. In *Weber*, the income on invested reserves returned to the insured; in the case at bar, the same income defrayed the insurance company's costs of management.

In *Weber*, each subscriber was both the insurer and the insured and losses were paid pro rata from the Catastrophe Loss Account made up of their premiums. Once the funds in this account were exhausted, the insurance company could not meet excess losses and the subscribers would have to meet excess losses themselves. Tri-State, however, had its own assets as well as the reserves paid in by other policyholders to cover excess claims. Petitioner's indemnity to Tri-State would be inadequate if, for example, Petitioner's gasoline-filled truck collided with a bus-load of children. Thus, the risk of loss was shifted from each insured in both cases to the insurance company, although excess losses might ultimately be paid by each subscriber. Shifting the insurance risk to the insurer occurs when the insurer contractually assumes the obligation to pay losses or judgments. That shift is not abrogated because the insurance company's source of funds ultimately flows back to its policyholders.

c. Risk of Loss, However Slight, Was Shifted To Tri-State. The Fifth Circuit concluded that risk of loss, a necessary element of insurance, was not shifted to Tri-State but had been shifted from Weber Paper Co. to its insurance company. Since the Fifth Circuit offered no definition of "shifting risk of loss," and the Eighth Circuit never discussed the point, there is a distinct conflict between these circuit court decisions because the facts show no difference existed in the shifting of loss in these two cases.

The insurance contracts in both cases caused the insurance company to assume an obligation for loss from flooding or from liability. At that moment, risk of loss in the insurance sense shifted to the insurance company. In both cases, the insurance company did everything possible to minimize or avoid the possibility of "non profit". In the *Weber* case, this was accomplished automatically, because the sole

source from which any insurance claims could be paid was represented by the reserve of premiums in an identical amount. The insurance company had no other assets from which excess claims could be paid. Its sole source of additional monies would be payment of additional premiums by the subscribers if required by their advisory committee.

In the instant case, the insurance company, Tri-State, did have other assets subject to claims of injured parties who would have had a right to look to Tri-State for compensation on the basis of the insurance agreement with Petitioner. Tri-State contracted extensively to reduce the possibility that its assumed risk of loss would be paid from its general assets. Instead of having an advisory committee which could require the contribution of additional premiums from Petitioner, Tri-State had an indemnity agreement which provided that Petitioner, to the extent of its assets, would *repay* to Tri-State any excess losses over the insurance reserve account maintained for those purposes. The indemnity merely provided Tri-State an opportunity to reduce its loss and to avoid non profit.

The distinction between "loss" in the sense of liability for flooding or accident claims and loss in the sense of failing to realize a profit between the amount of premiums collected and disbursements made must be recognized. Clearly, the risk of loss in the former sense was assumed by the insurance companies in both cases. The risk of "non profit" was avoided in *Weber* because the insurance company had no other assets. Non profit was minimized (but not completely avoided) by Tri-State through the use of the indemnity agreement.

d. Risk Distribution Existed In Both Cases. The Fifth Circuit concluded that "risk shifting to the insurer" had the effect of risk distribution as well. 577 F.2d at 280. Although

the District Court ruled that "fundamental aspects of an insurance agreement" are shifting of risk of loss and "genuine pooling of risk", the Fifth Circuit seemingly treated risk-shifting and risk distribution as "one of the requisites" or as an alternative requisite ["thus, there was no risk distribution by Steere, either". 577 F.2d at 280]. The definition of insurance qualifications in the Fifth Circuit therefore is at best inconclusive. And, if those qualifications are compared against the absence of any express requirement of "risk shifting" and "risk distribution" in *Weber*, the confusion is compounded. Two contradictions are apparent in this conflict:

First, according to the Fifth Circuit's decision, if a "risk shift" to Tri-State had occurred through the insurance arrangement, risk distribution also occurred. That conclusion follows because to whatever extent Tri-State *might* be forced to utilize its own funds or insurance reserves for the satisfaction of claims against Petitioner, those funds or reserves must have come from other Tri-State policyholders. The modesty of the risk that this liability might fall on Tri-State (according to the Fifth Circuit, it would occur only in the event of Petitioner's insolvency) does not detract from the reality of that possibility. In *Weber*, no claims had, in fact, ever been paid. Therefore, no *actual* risk distribution occurred. The test, therefore, must be the *prospect* of risk distribution and not its historical fact.

More importantly, however, in the instant case the insurance program involved a number of participants other than Petitioner. The lessor-operators indirectly paid for their insurance by an offset of their premiums against their lease income. Petitioner made these offsets and remitted the gross insurance premiums to Tri-State on behalf of the lessor-operators. The Fifth Circuit treated this distinct risk distribution as non-existent because the par-

ticular cash payments came from Petitioner's checking account. This conclusion is inconsistent with the Fifth Circuit's finding that the premium contract account could be used to pay losses suffered by Petitioner or the lessor-operators! 557 F.2d at 280. The formal payor of cash is not entitled to its tax benefit if, in fact, the payment is made on behalf of and out of the assets of another. The substance of the transaction and not its form controls. *See, Weinert v. Comm'r,* 294 F.2d 750 (5th Cir. 1961).

e. Insurance Programs That Are Based Upon Reciprocal Or Inter-Insurance And Are Funded By Retrospective Insurance Premiums Will Be Hopelessly Confused By The Conflict Between The Eighth Circuit And The Fifth Circuit. There is nothing magic about commercial insurance arrangements. Policyholders pay premiums to an insurance company which, in turn, places a portion of those premiums (depending on risk and local law) into a reserve. The earnings on that reserve are utilized to offset underwriting and management costs and to increase profit. In some cases, such as mutual insurance companies, the amount of premiums will vary from year to year and refunds or credits will be made depending upon the profitability of the insurance company, the size of its insurance losses, or the history of the particular policyholder's claims. The Internal Revenue Service has ruled that these premiums are nevertheless deductible notwithstanding refundability. *Rev.Rul. 60-275,* 1960-2 C.B. 43. If unusual risks exist, this premium adjustment is often contracted for in advance through the use of retrospective premium arrangements. These arrangements involve payment of very high premiums at the outset for modest insurance coverage. Subsequently, if the losses on that policy are adequately covered by the premium reserves, a refund or reduction will occur in later years to reduce the total

cost of the insurance. These arrangements are also viable for tax purposes. *Rev.Rul 73-302,* 1973-2 C.B. 220. The insurance company can agree to this ultimate reduction of insurance cost only because the particular contract arrangement protects it against some of the usual insurance risks and costs attendant upon mass insurance coverage.

In *Weber* and in the instant case, unusual insurance arrangements were developed to provide coverage that was not otherwise available in the market. Of course, both arrangements could have been handled through self-insurance; but they were not. In *Weber,* the amount of coverage was not in excess of the amount of premiums actually deposited. In *Steere,* Tri-State could have been liable for more than the premiums actually deposited. In both arrangements, refund of unused premiums was available to the insured as a downward adjustment in the cost of the insurance coverage. The "insurance element" of both arrangements involved the reserving of funds, the evidence of financial responsibility and coverage, and the contractual undertaking of risks by a licensed insurance company.

If these arrangements do not constitute legitimate insurance in the Fifth Circuit, but are proper in the Eighth Circuit, this Court should resolve the conflict. This Court has recognized that legitimate insurance arrangements may involve factors and features not present in "normal" insurance contracts. *Haynes v. U.S.,* 353 U.S. 82 (1957). The Fifth Circuit Court of Appeals has recognized that "the nature of insurance arrangements are almost infinite." *A. C. Ross v. Odom,* 401 F.2d 464, 420 (5th Cir. 1968). A uniform national rule should be established.

f. Beneficial Ownership In The Premium Reserve Was More Favorable In The Instant Case Than In *Weber.*

The District Court concluded that a true insurance agreement with Tri-State did not exist because it had no investment interest in the premium contract account. 577 F.2d at 283. Since the parties stipulated that the insurance agreements were not only executed but also were honored between the parties, the District Court's conclusion is in error. The ownership of and responsibility for the premium contract account was placed solely in Tri-State. Its separate, contractual arrangement with A & I did not relieve Tri-State of its obligations, both legal and contractual, to that reserve. The administrative costs of accident investigation, adjustment, litigation and financial management were paid on behalf of Tri-State from the reserve's income. These costs are normal and would otherwise have been incurred by an insurance company from its earnings. Therefore, the payment of these costs from this fund represented income used to offset Tri-State's operating obligations.

In *Weber,* however, the earnings from the insurance company's fund, which were under the management of its attorney-in-fact, were refundable to the subscribers. As this factor did not detract from the insurance arrangement in *Weber,* refundability should not defeat the insurance arrangement with Tri-State.

g. Petitioner's Indemnification To Tri-State Reflected The Fact That Tri-State Had Other Assets At Risk, Whereas In *Weber* The Insurance Company's Assets Were Limited To The Monies Supplied By The Subscribers. The District Court concluded that no insurance arrangement existed with Tri-State because of Petitioner's agreement to indemnify Tri-State against excess losses. The indemnity, according to the District Court, "effectively limits Tri-State's risk of liability to a risk of Steere's

insolvency." 577 F.2d at 281. The District Court's conclusion, however, does not negate the fact that the risk assumed by Tri-State was an insurance risk. In *Weber,* the subscribers had no reason to indemnify the insurance company since it had no assets other than the premiums contributed by the subscribers. Once the fund in *Weber* was exhausted, each subscriber bore its loss individually. In the instant case, Tri-State did have assets other than the fund held in the premium contract account. These other assets would be used to pay excess losses in the event the premium contract account was exhausted. Petitioner's agreement to indemnify Tri-State did not eliminate Tri-State's assumed risk of loss, but only reduced the risk of non profit if Petitioner remained solvent. The risk assumed by Tri-State did constitute an insurance risk as did the risk assumed by the insurance company in *Weber.*

2. ASSUMING ARGUENDO THAT PETITIONER'S PAYMENTS DID NOT STRICTLY QUALIFY AS "INSURANCE PREMIUMS", THE PAYMENTS ARE DEDUCTIBLE AS EXPENSES OR LOSSES BECAUSE ALL EVENTS HAD OCCURRED CONFIRMING PETITIONER'S LIABILITY FOR PAYMENTS TO TRI-STATE UNDER A BINDING CONTRACT ENTERED INTO IN CONNECTION WITH PETITIONER'S TRADE OR BUSINESS.

Insurance premiums are not the only disbursements deductible by a business. If payments are made subject to obligations validly incurred in connection with that business, they may be deductible if they represent ordinary and necessary business expenses. *Section 162* of the Code.

Under the agreement with Tri-State, Petitioner's payments were an ordinary and necessary expense of doing

business and were properly deductible in the year paid since "all events" had occurred under the agreement fixing Petitioner's liability to Tri-State. *Section 461* of the Code; Treas. Reg. 1.461-1(a)(2).

The agreement between Petitioner and Tri-State, which agreement admittedly was valid and the result of arm's-length bargaining, governed the obligations of both parties. Petitioner's obligation was to pay certain amounts to Tri-State annually in consideration of Tri-State's providing the evidence of financial responsibility. This agreement controlled amounts due Tri-State and the method of computing these amounts. Petitioner's payments to Tri-State were compulsory under the agreement and were not voluntary. Had Petitioner failed to make the required annual payments, Tri-State would have had a claim against Petitioner and certain rights against Petitioner, including the right to terminate the agreement. Thus, Petitioner's payment to Tri-State was an ordinary and necessary expense of its business. *Accord, Vincent E. Oswalt,* 49 T.C. 645 (1968). In addition, all events had occurred in the year of payment fixing Petitioner's liability to Tri-State and fixing the amount, which was ascertainable, due to Tri-State. *Gillis v. United States,* 402 F.2d 501 (5th Cir. 1962). The District Court erroneously viewed Petitioner's liability as one owing to accident claimants instead of correctly recognizing that Petitioner's liability for purposes of §461 and §162 was to Tri-State.

The District Court and the Fifth Circuit found that Petitioner would not be entitled to a deduction under §162 and §461 because Petitioner's 1972 disbursement of $222,092.07 was essentially retained by Petitioner as its own reserve and subject to its own control. Therefore, the courts concluded, the amount did not represent a "payment" but rather was a retained reserve. This conclusion

is precisely contrary to the District Court's finding that Petitioner lost control of the funds, at least for a fixed period of time. 577 F.2d at 283.

Should this court decide that *Weber* does not require reversal of the Fifth Circuit's decision below on the ground that Petitioner's payments to Tri-State were not insurance premiums, this Court should allow a deduction for those payments on the ground the payments were ordinary and necessary business expenses incurred by Petitioner on the basis of a contract entered into as a necessary requisite of its trade or business. Those industries which operate at a high risk and which enter into unusual reciprocal or retrospective insurance arrangements will otherwise be hopelessly confused by the decision of the Fifth Circuit.

CONCLUSION

Although the insurance agreement in *Weber* is similar to and supports the arrangement in the instant case, the Fifth Circuit concluded that the Eighth Circuit decision in *Weber* did not apply. The Government had argued that *Weber* was wrong. The Fifth Circuit made a futile attempt to distinguish *Weber*. This conflict between the circuit courts should be resolved.

Petitioner, therefore, respectfully prays that this Court accept its Writ of Certiorari and resolve the conflict between the Fifth and Eighth Circuits as to the meaning and elements of true insurance.

Respectfully submitted,

Ronald M. Mankoff

Charles D. Pulman

3900 First National Bank Bldg.
Dallas, Texas 75202
(214) 748-0074

Attorneys for Petitioner

APPENDIX A

STEERE TANK LINES, INC.,
Plaintiff-Appellant.

v.

UNITED STATES of America,
Defendant-Appellee.

No. 76-3543.

United States Court of Appeals,
Fifth Circuit.

July 28, 1978.

Rehearing Denied Sept. 25, 1978.

Appeal was taken from a judgment of the United States District Court for the Northern District of Texas, Robert M. Hill, J., holding against taxpayer on its claim for a deductible business expense. The Court of Appeals held that amount paid by corporate taxpayer to insurance company into contract premium account from which were to be paid all accident claims against corporate taxpayer arising out of its transportation of petroleum products with any excess over amounts paid out for claims and administrative costs returned to corporate taxpayer after six years was not an insurance premium and hence a deductible business expense but a nondeductible reserve for accident claims.

Affirmed.

1. Insurance — 124

Risk shifting or risk distribution is one of requisites of true insurance contract.

2. Internal Revenue — 563

Amount paid by corporate taxpayer to insurance company into contract premium account from which were to be paid all accident claims against corporate taxpayer arising out of its transportation of petroleum products with any excess over amounts paid out for claims and administrative costs returned to corporate taxpayer after six years was not an insurance premium and hence a deductible business expense but essentially a nondeductible reserve for accident claims. 26 U.S.C.A. (I.R.C.1954) § 162(a).

Charles M. Meadows, Jr., Ronald M. Mankoff, Dallas, Tex., for plaintiff-appellant.

Michael P. Carnes, U. S. Atty., Martha Joe Stroud, Asst. U. S. Atty., Dallas, Tex., Gilbert E. Andrews, Chief, Appellate Section, Ann B. Durney, Aaron P. Rosenfeld, Attys., Tax Div. Dept. of Justice, Washington, D. C., for defendant-appellee.

Appeal from the United States District Court for the Northern District of Texas.

Before THORNBERRY, RONEY and HILL, Circuit Judges.

PER CURIAM:

Steere Tank Lines, Inc., which transports petroleum products in Texas and interstate commerce, is required by the Interstate Commerce Commission and state regulatory agencies to show evidence of financial responsibility for payment of accident claims. The sole issue in this case is whether the $222,000 paid by Steere in 1972, the tax year in question, was an insurance premium and hence a deductible business expense under § 162(a) of the Internal Revenue Code, 26 U.S.C.A. § 162(a), or essentially a nondeductible

reserve for accident claims. Holding it to be in the nature of a reserve payment, and not an insurance premium, we affirm the district court.

In 1964, Steere entered into an agreement with Tri-State Insurance Company, which denominates Steere as the "principal" and Tri-State as the "surety." Under that agreement, Tri-State provides Steere with an evidence of financial responsibility bond, but Steere agrees to indemnify Tri-State for all claims against it. The terms of the agreement are such that, effectively, the only risk Tri-State has is if Steere becomes insolvent.

Steere is obligated to pay two premiums to Tri-State each year. Steere paid a premium based upon a percentage of its gross revenues, with the minimum annual premium to be $6,000, for Tri-State's providing the evidence of financial responsibility. This premium was nonrefundable. In addition, Steere agreed to make payments into the "contract premium account." These payments, based upon a larger percentage of its gross revenues, amounted to $222,000 for 1972. It was from the contract premium account that claims against Steere were to be paid. Any excess amounts paid into the account over amounts paid out for claims and administrative costs are returned to Steere after six years (representing the maximum statute of limitations period for tort claims). Thus, every cent paid into the contract premium account could be returned to Steere if no claims were brought against it.

After a bench trial in the United States District Court for the Northern District of Texas, District Judge Robert Hill ruled that the agreement "failed to demonstrate the ordinary indicia of a legitimate insurance arrangement," since it neither shifted the risk of loss to Tri-State nor involved a genuine pooling of risk. He therefore held that the $222,000 paid into the contract premium account by

Steere was not deductible as an expense in 1972. He did, however, allow Steere to deduct the $114,000 paid out of that account in 1972 to settle claims against Steere.

We affirm on the basis of Judge Hill's opinion, annexed hereto as an appendix, which sets out the facts of this case in greater detail.

In its briefs and oral argument before this Court, Steere has relied heavily on the Eighth Circuit opinion in *United States v. Weber Paper Co.*, 320 F.2d 199 (8th Cir. 1963). In that case, several businesses which were unable to get flood insurance set up a reciprocal, inter-insurance plan, under which they paid yearly premiums to a corporation they set up for that purpose. Payments for losses were made, pro rata, from the fund composed of all subscribers' premiums. If a subscriber withdrew from the plan, up to 99% of its premium payments could be returned if no losses had been paid out of the common fund. The Eighth Circuit held the premiums paid under this plan to be deductible business expenses.

[1, 2] The government asserts that *Weber* was wrongly decided. *Compare* Rev.Rule 60—275, 1960—2 Cum.Bull. 43. We need not decide whether we would follow *Weber,* because we find it to be distinguishable from the present case. In *Weber,* a subscriber's premium payment would be used to pay flood losses suffered by other subscribers. Thus, there was an element of risk shifting to the insurer, which in turn distributed that risk of loss among all subscribers. Risk shifting or risk distribution is one of the requisites of a true insurance contract. In the present case, there was no shifting of the risk, since Steere was obligated to pay all losses. The premium contract account could be used only to pay losses suffered by Steere or its owner-lessors, but Steere was obligated to pay premiums for its owner-lessors, so in effect, Steere's losses were to be paid only out of a

fund made up of premiums Steere had paid. Thus, there was no risk distribution by Steere either.

In addition, we note one additional fact which indicates that this was not an insurance arrangement. ICC regulations provide that in order to engage in interstate commerce within a state which requires a motor carrier to maintain evidence of bodily injury and property damage liability security, the carrier must file with that state either "[1] a currently effective certificate of insurance or [2] surety bond." 49 C.F.R. § 1023.51 (1976). The regulations require the certificate or bond to follow the forms set out in the regulations. See 49 C.F.R. §§ 1023.52—.53 & Forms E & F (certificate of insurance); *id.* § 1023.54 & Form G (surety bond). Steere filed a *surety bond* and not a certificate of insurance with the ICC and the appropriate Texas state agency. This lends additional support to the conclusion that the $6,000 payment was the premium required for the evidence of financial securety (surety bond), and the $222,000 payment was in the nature of a reserve for payment of any claims against Steere.

AFFIRMED.

APPENDIX

FINDINGS OF FACT AND CONCLUSIONS OF LAW

(Number and title omitted)

(Filed: June 15, 1976)

This cause came on for hearing before the Court without a jury, the Honorable Robert M. Hill, United States District Judge, presiding. After considering the evidence and the arguments of counsel, the Court makes the following findings of fact and conclusions of law.

Findings of Fact

1. The plaintiff, Steere Tank Lines, Inc. (Steere) seeks a tax refund of $50,197.32 from the defendant, United States of America (government) for Steere's fiscal year ending February 29, 1972.

2. Steere is a Texas corporation with its principal place of business in Dallas, Texas which is engaged in the business of transporting petroleum products in Texas and other states and in interstate commerce.

3. The issue before the court is whether $222,092.07 Steere allegedly paid for insurance expenses in fiscal year 1972 is a deductible business expense as that term is defined in § 162(a) of the Internal Revenue Code, 26 U.S.C. § 162(a). The issue of deductibility in this case turns on whether Steere's insurance arrangement and payments pursuant to that arrangement are characterized as fixed and definite payments or deposits to a reserve account. The government characterizes Steere's insurance arrangement as essentially self-insurance. Steere characterizes this arrangement as a form of retrospective insurance policy. Steere further argues that this arrangement was the only means available to it to obtain adequate and necessary insurance protection. Steere therefore says a valid business necessity or purpose justifies the unusual nature of its insurance arrangement.

4. Proper characterization of Steere's insurance arrangement is controlled by its agreements with a company called Adjustment and Inspection Company (A & I) and the ostensible insurer, Tri-State Insurance Company of Tulsa, Oklahoma (Tri-State). The parties have stipulated that these agreements governed the parties' rights and their actions conformed to the agreements.

5. The Interstate Commerce Commission and state regulatory agencies require Steere to be properly insured

against accident claims arising from the operation of its trucks in such states and in interstate commerce.

6. Prior to 1959 Markel Insurance Company carried Steere's liability insurance coverage. Markel cancelled Steere's coverage in 1959 due to Steere's continued adverse claims experience.

7. Tri-State agreed to provide the I.C.C. and other agencies with the evidence of financial responsibility required by those agencies pursuant to an agreement executed between Tri-State and Steere on March 1, 1964. The agreement, as amended in 1968, governed the parties' insurance arrangement for the tax year in question.

8. The agreement between Tri-State and Steere was designed to limit any danger of liability to Tri-State except as a surety. The contract effectively limits Tri-State's risk of liability to a risk of Steere's insolvency. Among the many provisions designed to so limit Tri-State's risk was the one in which Steere agreed to fully indemnify Tri-State against any loss. Steere also agreed to defend Tri-State against any legal actions arising from the parties' agreement, an arrangement that reverses the ordinary insurance agreement. Further, the agreement obligated Steere to obtain and carry excess insurance.

9. The agreement provided that Steere pay two premiums to Tri-State. For providing the evidence of financial responsibility, Steere agreed to pay Tri-State a premium based upon a percentage of Steere's gross revenues with the minimum annual premium to be $6,000.00. (paragraph 4 of agreement) Secondly, Steere agreed to pay a premium to fund two accounts with Tri-State. The first of these accounts was a permanent premium advance of $60,000.00. The second account was the contract premium account into which Steere agreed to make payments based upon a

percentage of its gross sales. There was no evidence to indicate the basis upon which the parties negotiated the percentage. It was from this latter account that Steere was to satisfy any claims that might arise against it.

10. Tri-State possessed contractual rights designed to protect it against the possibility that Steere's insurance claims would exceed the funded contract premium account. As previously noted, the agreement obligated Steere to make regular payments into the contract premium account on the basis of Steere's gross revenues. Additionally, Steere was obligated, regardless of the regular payments, to maintain the account at a level at least equal to the total amount of Steere's accident claims. Tri-State could cause Steere to replace or add securities to the contract premium account if the value of securities deposited therein became impaired. Steere was obligated to notify Tri-State of all withdrawals from the account, and Tri-State had the right to inspect all of Steere's files and records. The surety assumed the defense of any bankruptcy action taken against Steere.

11. Contemporaneous with the agreement with Tri-State, Steere signed an agreement with Adjustment and Inspection Company (A & I) which had the effect of shifting to A & I the normal insurance duties of investigating, adjusting, settling or defending claims. A & I also served as a safety inspector and advisor for Steere. It undertook the management of the contract premium account. Profits from investment of the funds in the contract premium account were paid to A & I.

12. A & I was owned by trust established for the benefit of the children of Bruce and David Steere, each of whom owned fifty percent (50%) of Steere Tank Lines. Bruce Steere was president and chief executive officer of both A & I and Steere.

13. Universal Agency was Tri-State's agent for the Steere account. John Dorsey, who owned and ran Universal Agency, was vice-president of A & I and the person most directly responsible for A & I's operation. Universal received a premium for the $6,000 to $7,000 paid by Steere to Tri-State for Tri-State's posting a surety bond with the I.C.C. Universal did not receive a premium for Steere's payments into the contract premium account although the payments into the account were paid to Universal which forwarded them to A & I.

14. Steere's agreement with Tri-State provided that any excess amount paid into the premium contract account over amounts paid out for claims and administrative costs would be returned to Steere after the passage of six years.

15. Steere provided insurance coverage through the premium contract account for the trucks which it leased from independent contractors. Payments for this coverage were deducted from the lease payments.

16. In fiscal year 1972 Steere paid $114,422.46 from the premium contract account for claims and related expenses.

17. There was no evidence in the record to indicate whether Tri-State reported the payments made into the premium contract account as income to it.

18. Steere is an accrual basis taxpayer.

19. Any conclusion of law deemed a finding of fact is so adopted.

Conclusions of Law

1. The court has jurisdiction of the parties and subject matter, 28 U.S.C. §1346(a)(1).

2. Reserves or deposits established by a taxpayer against contingent or future liabilities are not currently deductible.

Thus, a taxpayer who establishes a reserve in an effort to ensure against future losses is not entitled to a deduction at the time the reserve is established or funded. A deduction is proper when the liability becomes fixed.

3. Steere's payment of $222,092.07 in the premium contract account in fiscal year 1972 was not a fixed and definite expense at that time. Tri-State was not Steere's insurer because Tri-State has no risk beyond Steere's insolvency. Steere's payment into the premium contract account has no demonstrable relationship to Steere's claims experience or expectations. Tri-State has no competitive incentive to keep the premiums low. In fact, Tri-State's only incentive was to extract payments as large as possible in order to protect itself against its only risk, Steere's insolvency. In effect, Steere was in a position to unilaterally name any figure above a minimum required by Tri-State to protect against its limited risk. If such payments were fully deductible, Steere would be in a position to defer taxation of an indeterminate portion of its income for several years. It is true of course that Steere loses the benefit or control of these funds for a period until they are returned as provided in the agreement. The court is of the opinion that mere loss of control is not sufficient to establish deductibility especially when the "loss" is limited by an agreement to return a portion of the funds at a later time and when the loss of control is to a company related to Steere by common ownership and management.

4. The Tri-State/Steere/A & I agreement lacked the fundamental aspects of an insurance agreement since the agreement did not shift the risk of loss to Tri-State, and there was no genuine pooling of risk. As of the lease operators, they shifted their risk to Steere, not to

Tri-State. Tri-State has no investment interest in the account.

5. The agreement failed to demonstrate the ordinary indicia of a legitimate insurance arrangement that justifies the deduction of such business expenses in the usual case. In truth, the plan more closely approximates a clever estate planning device.

6. The $222,092.07 paid into the permium contract account in fiscal year 1972 was not an expense made deductible by § 162(a); nor did the payment satisfy the "all events test" of 26 U.S.C.A. § 461(a). Steere was not entitled, therefore, to deduct this payment although it was entitled to deduct $114,422.46 paid out of the premium contract account during fiscal year 1972 for claims and related expense.

7. Any finding of fact deemed a conclusion of law is so adopted.

8. Judgment in accordance with findings shall be prepared by defendant, forwarded to plaintiff for its approval as to form, and returned to the court within fourteen (14) days of the entry of this order.

Dated this 15th day of June, 1976.

s/ Robert M. Hill
United States District Judge

APPENDIX B

¶ 76-5136

STEERE TANK LINES, INC., PLAINTIFF v. U.S., DEFENDANT. U.S. District Court, Northern Dist. of Texas, Dallas Div., Civil Action No. CA-3-75-0712-D, June 15, 1976. Year 1972. Decision for Govt.

1. **BUSINESS EXPENSES — Business insurance — reserve for self insurance.** Business expense deduction denied accrual basis petroleum products transporting corp. for payments made under insurance arrangements: it was essentially self insurance. Corp. had obtained mandatory insurance by creating co. to maintain reserve fund after original insurer cancelled coverage. Corp.'s loss of control over funds in reserve didn't establish deductibility since agreement limited losses by providing for repayment of part of reserve. Also, insurer co. was related to corp. by common ownership and management. Agreement didn't shift risk of loss, create genuine pooling of risk, or create investment interest. *Reference:* 1976 P-H Fed. ¶11,114. Sec. 162.

C. M. Meadows, Jr., 3900 First Nat. Bk. Bldg., Dallas, Tex., Atty. for Plaintiff.

William W. Guild, Atty., Tax Div., Dept. of Justice, 1100 Commerce, Dallas, Tex., for Defendant.

HILL, District Judge:

Findings Of Fact And
Conclusions Of Law

This cause came on for hearing before the Court without a jury, the Honorable Robert M. Hill, United States District Judge, presiding. After considering the evidence and the arguments of counsel, the Court makes the following findings of fact and conclusions of law.

Findings of Fact

1. The plaintiff, Steere Tank Lines, Inc. (Steere) seeks a tax refund of $50,197.32 from the defendant, United States of America (government) for Steere's fiscal year ending February 29, 1972.

2. Steere is a Texas corporation with its principal place of business in Dallas, Texas which is engaged in the business of transporting petroleum products in Texas and other states and in interstate commerce.

[1] 3. The issue before the court is whether $222,092.07 Steere allegedly paid for insurance expenses in fiscal year 1972 is a deductible business expense as that term is defined in §162(a) of the Internal Revenue Code, 26 U.S.C. §162(a). The issue of deductibility in this case turns on whether Steere's insurance arrangement and payments pursuant to that arrangement are characterized as fixed and definite payments or deposits to a reserve account. The government characterizes Steere's insurance arrangement as essentially self-insurance. Steere characterizes this arrangement as a form of retrospective insurance policy. Steere further argues that this arrangement was the only means available to it to obtain adequate and necessary insurance protection. Steere therefore says a valid business necessity or purpose justifies the unusual nature of its insurance arrangement.

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against accident claims arising from the operation of its trucks in such states and in interstate commerce.

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8. The agreement between Tri-State and Steere was designed to limit any danger of liability to Tri-State except as a surety. The contract effectively limits Tri-State's risk of liability to a risk of Steere's insolvency. Among the many provisions designed to so limit Tri-State's risk was the one in which Steere agreed to fully indemnify Tri-State against any loss. Steere also agreed to defend Tri-State against any legal actions arising from the parties' agreement, an arrangement that reverses the ordinary insurance agreement. Further, the agreement obligated Steere to obtain and carry excess insurance.

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of its gross sales. There was no evidence to indicate the basis upon which the parties negotiated the percentage. It was from this latter account that Steere was to satisfy any claims that might arise against it.

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17. There was no evidence in the record to indicate whether Tri-State reported the payments made into the premium contract account as income to it.

18. Steere is an accrual basis taxpayer.

19. Any conclusion of law deemed a finding of fact is so adopted.

Conclusions of Law

1. The court has jurisdiction of the parties and subject matter. 28 U.S.C. §1346(a)(1).

2. Reserves or deposits established by a taxpayer against contingent or future liabilities are not currently deductible.

Thus, a taxpayer who establishes a reserve in an effort to ensure against future losses is not entitled to a deduction at the time the reserve is established or funded. A deduction is proper when the liability becomes fixed.

3. Steere's payment of $222,092.07 in the premium contract account in fiscal year 1972 was not a fixed and definite expense at that time. Tri-State was not Steere's insurer because Tri-State has no risk beyond Steere's insolvency. Steere's payment into the premium contract account has no demonstrable relationship to Steere's claims experience or expectations. Tri-State has no competitive incentive to keep the premiums low. In fact, Tri-State's only incentive was to extract payments as large as possible in order to protect itself against its only risk, Steere's insolvency. In effect, Steere was in a position to unilaterally name any figure above a minimum required by Tri-State to protect against its limited risk. If such payments were fully deductible, Steere would be in a position to defer taxation of an indeterminate portion of its income for several years. It is true of course that Steere loses the benefit or control of these funds for a period until they are returned as provided in the agreement. The court is of the opinion that mere loss of control is not sufficient to establish deductibility especially when the "loss" is limited by an agreement to return a portion of the funds at a later time and when the loss of control is to a company related to Steere by common ownership and management.

4. The Tri-State/Steere/A&I agreement lacked the fundamental aspects of an insurance agreement since the agreement did not shift the risk of loss to Tri-State, and there was no genuine pooling of risk. As to the lease operators, they shifted their risk to Steere, not to Tri-State. Tri-State has no investment interest in the account.

5. The agreement failed to demonstrate the ordinary indicia of a legitimate insurance arrangement that justifies the deduction of such business expenses in the usual case. In truth, the plan more closely approximates a clever estate planning device.

6. The $222,092.07 paid into the premium contract account in fiscal year 1972 was not an expense made deductible by §162(a); nor did the payment satisfy the "all events test" of §461(a). Steere was not entitled, therefore, to deduct this payment although it was entitled to deduct $114,422.46 paid out of the premium contract account during fiscal year 1972 for claims and related expense.

7. Any finding of fact deemed a conclusion of law is so adopted.

8. Judgment in accordance with findings shall be prepared by defendant, forwarded to plaintiff for its approval as to form, and returned to the court within fourteen (14) days of the entry of this order.

APPENDIX C

§ 162. Trade or business expenses

(a) In general. — There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

For purposes of the preceding sentence, the place of residence of a Member of Congress (including any Delegate and Resident Commissioner) within the State, congressional district, or possession which he represents in Congress shall be considered his home, but amounts expended by such Members within each taxable year for living expenses shall not be deductible for income tax purposes in excess of $3,000.

APPENDIX D

§ 461. General rule for taxable year of deduction

(a) General rule. — The amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used incomputing taxable income.

APPENDIX E

Income Tax Regulations

Year of Deduction

§ 1.461-1. General rule for taxable year of deduction.

(a) *General rule* — (1) *Taxpayer using cash receipts and disbursements method.* Under the cash receipts and disbursements method of accounting, amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid. Further, a taxpayer using this method may also be entitled to certain deductions in the computation of taxable income which do not involve cash disbursements during the taxable year, such as the deductions for depreciation, depletion, and losses under sections 167, 611, and 165, respectively. If an expenditure results in the creation of an asset having a useful life which extends substantially beyond the close of the taxable year, such an expenditure may not be deductible, or may be deductible only in part, for the taxable year in which made. An example is an expenditure for the construction of improvements by the lessee on leased property where the estimated life of the improvements is in excess of the remaining period of the lease. In such case, in lieu of the allowance for depreciation provided by section 167, the basis shall be amortized ratably over the remaining period of the lease. See section 178 and the regulations thereunder for rules governing the effect to be given renewal options in determining whether the useful life of the improvements exceeds the remaining term of the lease where a lessee begins improvements on leased property after July 28, 1958, other than improvements which on such date and at all times thereafter the lessee was under a binding legal obligation to make. See section 263 and the regulations thereunder for rules relating to capital expenditures.

(2) *Taxpayer using an accrual method.* Under an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability and the amount thereof can be determined with reasonable accuracy. However, any expenditure which results in the creation of an asset having a useful life which extends substantially beyond the close of the taxable year may not be deductible, or may be deductible only in part, for the taxable year in which incurred. While no accrual shall be made in any case in which all of the events have not occurred which fix the liability, the fact that the exact amount of the liability which has been incurred cannot be determined will not prevent the accrual within the taxable year of such part thereof as can be computed with reasonable accuracy. For example, A renders services to B during the taxable year for which A claims $10,000. B admits the liabiilty to A for $5,000 but contests the remainder. B may accrue only $5,000 as an expense for the taxable year in which the services were rendered. In the case of certain contested liabilities in respect of which a taxpayer transfers money or other property to provide for the satisfaction of the contested liability, see § 1.461-2. Where a deduction is properly accrued on the basis of a computation made with reasonable accuracy and the exact amount is subsequently determined in a later taxable year, the difference, if any, between such amounts shall be taken into account for the later taxable year in which such determination is made.